

# ***Indiana Legislative Services Agency***

## ***Fiscal Issue Brief***

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### **The Corporate Income Tax in Indiana**

There has been substantial coverage of the decline in corporate income tax revenues as a share of total tax revenues at the national and state levels over the past decade. For example, a recent report by the federal General Accounting Office, which has been referenced in numerous newspapers, finds that a majority of corporations reported no federal corporate income tax liability during the 1996-2000 period.<sup>1</sup> This issue brief examines Indiana's corporate income tax prior to Indiana's 2002 tax restructuring. It focuses on changes in the corporate income tax collections as a share of total tax collections over the past decade, the distribution of corporations by type, and the distribution of income tax liability among Indiana corporations.

The decrease in the corporate share of total state tax collections has generally been linked to four causes: (1) cyclical declines in profits, (2) erosion of the federal corporate tax base, (3) state policy decisions to decrease corporate tax burdens, and (4) aggressive corporate tax planning and increased use of tax shelters.<sup>2</sup> During recessions or periods of slow economic growth as have occurred over the past few years, corporate profits decline, as does corporate income tax liability.

The calculation of corporate income tax liability in most states (including Indiana) begins with federal corporate taxable income and then allows for some additions and subtractions. A decrease in the federal corporate tax base, either as a result of federal policy changes, tax planning by corporations, or increased use of tax shelters will decrease state corporate tax bases and state corporate tax revenue.

States have enacted several types of policies that have reduced the corporate tax base and tax burdens. Increased deductions and exemptions have eroded the tax base. Various business tax credits, such as investment and employment tax credits, have decreased corporate tax burdens. Changes in apportionment formulas have lowered the tax burden for multistate corporations. Corporations have reorganized to take advantage of tax rate differentials and thereby reduce corporate tax burdens. For example, Indiana businesses that pay taxes through the individual income tax system face a 3.4 percent tax rate while businesses that pay taxes through the corporate tax system face a tax rate of 8.5 percent.

Various corporate strategies, including increased use of tax planning, have led to deterioration in state corporate income tax bases. The use of passive investment corporations and the classification of income from business income to nonbusiness income have been used to minimize corporate taxable income and tax liability.

#### **Corporate Income Taxes in Indiana**

The income tax is only one of the taxes that corporations pay. Corporations actually pay substantially more sales/use tax and property tax than income tax. For example, the Council on State Taxation estimates that in FY 2003, property taxes were 39 percent, sales taxes on business inputs (not the amount collected from customers for state and local governments) were 25 percent, and corporate

<sup>1</sup> General Accounting Office. "Comparison of the Reported Tax Liabilities of Foreign- and U.S.-Controlled Corporations, 1996-2000, GAO 04-358, February 2004.

<sup>2</sup> For a more detailed analysis, see Luna, LeAnn and Fox, William F. "State Corporate Tax Revenue Trends: Causes and Possible Solutions," National Tax Journal, Sept. 2002, pp. 491-508.

income taxes were 9 percent of the total state and local business taxes.<sup>3</sup> In addition to the corporate income tax, a substantial share of business income is taxed through the individual income tax system.<sup>4</sup>

Traditionally, discussions of Indiana corporate income taxes refer to the Gross Income Tax, Corporate Adjusted Gross Income Tax and the Supplemental Net Income Tax (SNIT). In Table 1, we examine a broader definition of corporate income and include financial institutions, insurance, utilities, and riverboat taxes. The last three columns of Table 1 show three measures of the corporate share of total state tax collections. Column VII uses the narrowest definition of corporate tax collections (C corporations, special corporations, and utilities) as a share of total state tax collections and shows that the share of corporate tax collections has decreased substantially over the past several years.

**Table 1: Corporate Income-Based Tax Collections as a Percent of Total State Tax Collections, 1990-2003**

I	II	III	IV	V	VI	VII	VIII	IX
Fiscal Year	Corporate (millions \$)	FIT <sup>a</sup> (millions \$)	Insurance (millions \$)	Utility Receipts <sup>b</sup> (millions \$)	Riverboat Taxes <sup>a,c</sup> (millions \$)	Corporate as a Percent of Total State Tax Collections <sup>d</sup>	Expanded Corporate <sup>e</sup> (without Riverboat Taxes) as a Percent of Total State Tax Collections <sup>f</sup>	Expanded Corporate <sup>e</sup> (with Riverboat Taxes) as a Percent of Total State Tax Collections <sup>g</sup>
1990	753.3	-	107.5	-	-	12.5%	14.3%	14.3%
1991	642.2	62.7	123.4	-	-	10.4%	13.2%	13.4%
1992	639.7	71.3	121.2	-	-	10.1%	13.0%	13.1%
1993	669.8	110.0	121.0	-	-	9.9%	13.2%	13.3%
1994	866.9	108.1	132.5	-	-	11.7%	14.8%	15.0%
1995	896.8	100.7	135.7	-	-	11.2%	14.1%	14.2%
1996	911.7	122.0	135.1	-	18.0	10.8%	13.8%	13.9%
1997	922.0	100.7	136.3	-	199.2	10.3%	12.9%	14.9%
1998	950.5	96.0	146.9	-	322.7	9.8%	12.3%	15.5%
1999	1,006.6	81.9	155.4	-	401.7	10.3%	12.7%	16.5%
2000	950.3	79.4	161.1	-	443.3	9.6%	11.9%	16.1%
2001	842.5	55.6	147.9	-	465.4	8.5%	10.5%	15.0%
2002	687.9	63.7	178.6	-	509.6	7.2%	9.6%	14.6%
2003	572.7	123.4	177.3	75.9	667.0	6.1%	8.9%	14.9%

Source: Indiana Handbook of Taxes, Revenues, and Appropriations, various years.

<sup>a</sup> State and Local share of FIT and Riverboat tax collections are included.

<sup>b</sup> As a result of the 2002 Tax Restructuring, the corporate Gross Income Tax was repealed for all corporations except utilities. Beginning in 2003, the Utility Receipts Tax became its own tax category.

<sup>c</sup> The first Indiana casino (Casino Aztar in Evansville) commenced full-time gaming on Dec. 8, 1995.

<sup>d</sup> Utilities are included in the 2003 share.

<sup>e</sup> Expanded corporate includes tax revenues from corporations, insurance companies, financial institutions, and utilities. Riverboat taxes are included as noted.

<sup>f</sup> Total state tax collections were adjusted for local FIT distributions.

<sup>g</sup> Total state tax collections were adjusted for local FIT distributions and local Riverboat Tax distributions.

In column VIII an expanded definition of corporate income tax collections is used including corporations (C corporations, special corporations, and utilities), financial institutions, and insurance companies. With this definition the decline in the corporate share of total tax collections is less dramatic. Column IX adds riverboat taxes, which have been in effect since 1996. With this even broader definition, the corporate share of state tax collections is relatively stable.

<sup>3</sup> Snell, Ronald. *New Realities in State Finance*, National Conference of State Legislatures, April 2004, page 51.

<sup>4</sup> Forms of business organization taxed under Indiana's individual rather than corporate income tax systems include sole proprietorships, partnerships, S corporations and various other joint ventures. Limited Liability Companies (LLCs) that elect to be treated as partnerships or sole proprietorships are taxed through Indiana's individual income tax system.

Table 1 does not reflect business income that flows through Indiana's individual income tax system. LSA calculations show that in 2001 5.5 percent of total tax collections was attributable to businesses filing individual income tax returns (6.4 percent in 1999). Businesses filing individual income tax returns generated income tax revenue of approximately \$540 M in 2001 and \$630 M in 1999 (not adjusted for inflation).<sup>5</sup> If business income taxed through the individual income tax system were included in the Table 1, business income tax collections (including corporate, FIT, insurance, utility receipts, and business income taxed through the individual income tax) would be 15.6 percent of total state tax collections in 2001 and 18.7 percent of total tax collections in 1999. If riverboat taxes are included, business income taxes would be 18.6 percent and 21.2 percent of total state tax collections in 2001 and 1999, respectively. Historical data on business income taxed through Indiana's Individual Income Tax system is not available.

### **Distribution of Corporate Income Tax Returns**

In Indiana five types of returns are used in the corporate income tax system: returns for C corporations, special corporations<sup>6</sup>, partnerships, S corporations, and financial institutions.<sup>7</sup> The S corporation (IT-20S) and partnership (IT-65) returns filed through the corporate income tax system are primarily information returns. A small portion of these returns include income and sales/use tax payments for nonresidents with only one Indiana partnership or S corporation. Most shareholders in S corporations or partners in partnerships pay income tax through the individual income tax system. Table 2 shows a substantial decline in the share of corporations filing as C corporations and a shift to filing as S corporations and partnerships (to a more limited extent over the past few years), which suggests that corporate reorganization has taken place.

**Table 2: Share of Corporate Returns, By Corporation Type**

Year	C Corporations IT-20 (%)	Special Corporations IT-20SC (%)	Partnerships IT-65 (%)	S Corporations IT-20S (%)	Financial Institutions FIT-20 (%)	Number of Returns
1984	24.7	18.0	24.7	32.6	-	85,006
1985	15.3	19.1	28.6	37.0	-	77,250
1986	15.5	19.3	28.4	36.8	-	82,279
1987	12.0	19.4	24.7	43.9	-	80,227
1988	17.4	19.6	24.5	38.5	-	93,715
1989	17.1	18.9	23.7	40.3	-	98,951
1990	18.1	18.2	21.7	41.9	-	111,004
1991	17.0	18.1	21.0	43.9	-	113,323
1992	16.4	17.4	20.2	45.4	0.6	115,410
1993	15.7	17.1	19.6	47.0	0.6	119,210
1994	15.5	16.7	19.2	48.1	0.5	123,624
1995	15.4	16.4	18.5	49.2	0.5	135,498
1996	15.4	15.8	19.3	48.9	0.5	136,275
1997	13.4	13.8	21.3	51.1	0.4	142,943
1998	14.7	13.1	21.6	50.1	0.5	135,081
1999	14.6	12.1	22.4	50.4	0.4	159,262
2000	14.1	11.3	23.4	50.7	0.4	162,904
2001	13.2	10.5	24.5	51.5	0.4	163,866

Source: Indiana Department of State Revenue (DOR) for 1984-1997 data. LSA analysis of Indiana DOR data for 1998-2001.

Note: Totals may not sum to 100 percent due to rounding.

<sup>5</sup> See LSA Fiscal Issue Brief: Business Income Subject to Indiana's Individual Income Tax for a more detailed analysis.

<sup>6</sup> Special Corporations are corporations that could file as S corporations through the individual income tax system but choose to file a corporate return through Indiana's corporate tax system because of certain tax advantages available to this type of corporation. Special Corporations were eliminated during the 2002 tax restructuring.

<sup>7</sup> The Indiana Department of State Revenue also collects information from nonprofits via form IT-20NP. Information on nonprofits is not available in LSA databases and therefore is not included in this analysis.

### **Distribution of Corporate Income Tax Liability**

The following analysis uses 1999 and 2001 data. Corporate income tax data for 2003, which will begin to reflect the changes from tax restructuring, will not be available for analysis until the fall of 2005. During these years the Indiana corporate Gross Income Tax, corporate Adjusted Gross Income Tax, and Supplemental Net Income Tax (SNIT) were in effect. With the 2002 tax restructuring, the Gross Income Tax and SNIT were repealed, and beginning in 2003 a corporate Adjusted Gross Income Tax was in effect with a tax rate of 8.5 percent. The tax rate for the individual Adjusted Gross Income Tax is 3.4 percent, so businesses that pay taxes through the individual income tax system (sole proprietorships, partnerships, and S corporations) pay a lower tax rate than corporations. Table 3 shows the 2001 and current tax rates for various types of businesses in Indiana.

**Table 3: Tax Rates for Business Income-Based Taxes, 2001 and Current**

	<b>2001</b>	<b>Current</b>
Corporate	Gross Income Tax rate of 0.3% -OR- 1.2% depending on industry. AGI Tax rate 3.4% SNIT rate 4.5%	AGI Tax rate 8.5%
Financial Institutions (FIT)	AGI Tax rate of 8.5%	AGI Tax rate of 8.5%
Insurance	Premium Tax of 1.9% of net premiums* Fire Insurance Tax of 0.5% of net premiums	Premium Tax of 1.7% of net premiums* Fire Insurance Tax of 0.5% of net premiums
Utility Receipts	Gross Income Tax rate of 1.2%	Gross Receipts rate of 1.4%
Riverboat Taxes	Admission Tax of \$3 per admission Wagering Tax of 20% of adjusted gross receipts	Admission Tax of \$3 per admission Wagering tax of 22.5% of adjusted gross receipts -OR- A graduated rate schedule ranging from 15% to 35% if the boat implements flexible scheduling
Sole Proprietorships, S Corporations, and Partnerships taxed through the Indiana Individual Income Tax system	Adjusted Gross Income Tax rate of 3.4%	Adjusted Gross Income Tax rate of 3.4%

Source: Indiana Handbook of Taxes, Revenues, and Appropriations, 2001 and 2003.

\* In 2000 an incremental decrease in the insurance premium tax began from its former level of 2% to 1.3% in 2005.

In 2001 approximately 39,450 Indiana corporate income tax returns were filed: about 580 returns from financial institutions, 21,600 returns from C corporations, and 17,250 returns from Special Corporations.<sup>8</sup> Table 4 shows the distribution of tax liability for these types of corporations. Just over 44 percent of these corporations had no income tax liability in 2001. Almost 88 percent of corporations pay \$10,000 or less in income tax. Approximately 2.5 percent of corporations (1,000 corporations) pay almost 80 percent of corporate income tax liability.

<sup>8</sup> Corporate income tax returns in Indiana are IT-20 for C corporations, FIT-20 for financial institutions and IT-20SC for special corporations. In addition, over 124,000 information returns were filed for partnerships and S corporations using IT-65 and IT-20S returns and are not included in the analysis. Analysis of the distribution of tax liability among Indiana corporate income tax returns is based on the number of corporate returns available in LSA databases as of May 2004.

**Table 4: 2001 Distribution of Corporate Income Tax Liability, C-corporations, Special Corporations, and Financial Institutions**

Corporate Income Tax Liability	Number of Returns	Percent of Returns	Cumulative Percent of Returns	Income Tax Liability* (\$)	Percent of Total Tax Liability
NONE (No Tax Liability)	17,471	44.3	44.3	0	0.0
\$1 - \$5,000	15,212	38.6	82.9	17,342,396	2.3
\$5,000 - \$10,000	2,003	5.1	88.0	14,254,076	1.9
\$10,000 - \$25,000	1,954	5.0	93.0	30,726,070	4.1
\$25,000 - \$50,000	1,053	2.7	95.7	37,276,970	5.0
\$50,000 - \$100,000	755	1.9	97.6	54,081,322	7.2
\$100,000 - \$250,000	567	1.4	99.0	88,566,390	11.8
\$250,000 - \$500,000	220	.6	99.6	76,413,540	10.2
\$500,000 - \$1,000,000	123	.3	99.8	82,954,798	11.1
Over \$1,000,000	91	.2	100.0	347,086,130	46.4
<b>Total</b>	<b>39,449</b>	<b>100.0</b>		<b>748,701,692</b>	<b>100.0</b>

Source: LSA analysis of Indiana DOR data. Note: Percentages may not sum to 100 due to rounding.

\* Note: The income tax liability total shown in Table 4 is derived from the corporate income tax returns submitted for calendar year 2001 (and 1999 in Table 7). The data on corporate tax collections presented in Table 1 is derived from estimated tax payments for the 2001 fiscal year and includes refunds for previous years, additional payments, and overpayment credits applied to future years.

#### **Distribution of Corporate Tax Liability for MultiState Corporations and Corporations with Only Indiana Location(s)**

The distribution of corporate tax liability for multistate corporations and for corporations that only have locations in Indiana is shown in Tables 5 and 6, respectively.<sup>9</sup> While multistate corporations represent about 35 percent of tax returns filed, these corporations pay about 83 percent of total corporate income tax. More than twice as many corporations with only Indiana locations have no tax liability relative to multistate corporations, 54.8 percent and 24.9 percent respectively.

In both cases, a small number of corporations pay the bulk of corporate income taxes. For multistate corporations, about 385 corporations pay just over 70 percent of the total corporate income tax liability. For corporations with only Indiana locations, about 311 corporations pay just over 70 percent of total corporate income tax liability.

**Table 5: 2001 Distribution of Corporate Income Tax Liability, Multistate corporations**

Corporate Income Tax Liability	Number of Returns	Percent of Returns	Cumulative Percent of Returns	Income Tax Liability (\$)	Percent of Total Tax Liability
NONE (No Tax Liability)	3,471	24.9	24.9	0	0.0
\$1 - \$5,000	5,814	41.8	66.7	7,025,394	1.1
\$5,000 - \$10,000	1,074	7.7	74.4	7,729,793	1.2
\$10,000 - \$25,000	1,327	9.5	83.9	21,174,062	3.4
\$25,000 - \$50,000	787	5.7	89.6	28,039,221	4.5
\$50,000 - \$100,000	613	4.4	94.0	43,807,359	7.0
\$100,000 - \$250,000	447	3.2	97.2	69,992,906	11.2
\$250,000 - \$500,000	191	1.4	98.6	66,812,869	10.7
\$500,000 - \$1,000,000	115	.8	99.4	77,550,289	12.4
Over \$1,000,000	79	.6	100.0	301,872,649	48.4
<b>Total</b>	<b>13,918</b>	<b>100.0</b>		<b>624,004,542</b>	<b>100.0</b>

<sup>9</sup> Corporations that apportion income are considered multistate corporations.

**Table 6: 2001 Distribution of Corporate Tax Liability, Corporations with Indiana Location(s) only**

Corporate Income Tax Liability	Number of Returns	Percent of Returns	Cumulative Percent of Returns	Income Tax Liability (\$)	Percent of Total Tax Liability
NONE (No Tax Liability)	14,000	54.8	54.8	0	0.0
\$1 - \$5,000	9,398	36.8	91.6	10,317,003	8.3
\$5,000 - \$10,000	929	3.6	95.2	6,524,283	5.2
\$10,000 - \$25,000	627	2.5	97.7	9,552,008	7.7
\$25,000 - \$50,000	266	1.0	98.7	9,237,749	7.4
\$50,000 - \$100,000	142	.6	99.3	10,273,963	8.2
\$100,000 - \$250,000	120	.5	99.8	18,573,484	14.9
\$250,000 - \$500,000	29	.1	99.9	9,600,670	7.7
\$500,000 - \$1,000,000	8	.0	100.0	5,404,508	4.3
Over \$1,000,000	12	.0	100.0	45,213,481	36.3
<b>Total</b>	<b>25,531</b>	<b>100.0</b>		<b>124,697,149</b>	<b>100.0</b>

Source: LSA analysis of Indiana DOR data. Note: Percentages may not sum to 100 due to rounding.

The 1999 distribution of corporate income tax liability is compared to that of 2001 to examine how this distribution fluctuates with the business cycle. The distribution of tax liability for all corporations (C corporations, special corporations, and financial institutions), multistate corporations, and corporations with only Indiana location(s) are shown in Tables 7, 8, and 9. The year 1999 was part of a period of economic expansion, while much of 2001 was in a recessionary period followed by a period of slow economic growth. This comparison highlights the economic contraction and decline in business activity and income that occurred during this period.

**Table 7: 1999 Distribution of Corporate Tax Liability: C-Corporations, Special Corporations, and Financial Institutions**

Corporate Income Tax Liability	Number of Returns	Percent of Returns	Cumulative Percent of Returns	Income Tax Liability* (\$)	Percent of Total Income Tax Liability
NONE (No Tax Liability)	17,886	41.4	41.4	0	0.0
\$1 - \$5,000	17,172	39.7	81.1	20,428,363	2.1
\$5,000 - \$10,000	2,400	5.5	86.6	17,065,857	1.8
\$10,000 - \$25,000	2,292	5.3	91.9	36,554,508	3.8
\$25,000 - \$50,000	1,261	2.9	94.8	44,786,728	4.7
\$50,000 - \$100,000	882	2.0	96.9	62,367,973	6.5
\$100,000 - \$250,000	743	1.7	98.6	116,635,519	12.1
\$250,000 - \$500,000	298	.7	99.3	102,973,564	10.7
\$500,000 - \$1,000,000	179	.4	99.7	122,113,726	12.7
Over \$1,000,000	132	.3	100.0	438,054,124	45.6
<b>Total</b>	<b>43,245</b>	<b>100.0</b>		<b>960,980,362</b>	<b>100.0</b>

Source: LSA analysis of Indiana DOR data. Note: Percentages may not sum to 100 due to rounding.

\* See note to Table 4.

As expected, the total corporate income tax liability was higher, the share of returns with no tax liability was lower, and more returns were filed in 1999 than in 2001. However, the distribution of tax liability among returns in 1999 is not substantially different from that of 2001. In 1999 a larger share of returns is at the upper end of the distribution. This has the largest impact on corporations with only Indiana locations. In 1999, 0.4 percent of corporations with only Indiana locations had tax liability of \$250,000 or more and paid just over 58 percent of total corporate income tax liability, while in 2001 just over 0.1

percent of these corporations had tax liability of \$250,000 or more and paid just over 48 percent of tax liability.

While the dollar amounts reported for 1999 and 2001 are not strictly comparable since the 1999 tax liability categories and tax liability are not adjusted for inflation, general comparisons can be made. The inflation rate was 6.3 percent between 1999 and 2001 as measured by the Consumer Price Index for urban consumers.

**Table 8: 1999 Distribution of Corporate Tax Liability, Multistate Corporations**

Corporate Income Tax Liability	Number of Returns	Percent of Returns	Cumulative Percent of Returns	Income Tax Liability (\$)	Percent of Total Tax Liability
NONE (No Tax Liability)	4,687	28.3	28.3	0	0
\$1 - \$5,000	6,487	39.2	67.5	8,145,628	1.1
\$5,000 - \$10,000	1,217	7.4	74.9	8,761,089	1.2
\$10,000 - \$25,000	1,454	8.8	83.7	23,579,462	3.1
\$25,000 - \$50,000	933	5.6	89.3	33,288,125	4.4
\$50,000 - \$100,000	665	4.0	93.3	46,930,885	6.2
\$100,000 - \$250,000	590	3.6	96.9	93,228,094	12.3
\$250,000 - \$500,000	241	1.5	98.4	83,588,449	11.0
\$500,000 - \$1,000,000	160	1.0	99.3	108,586,368	14.3
Over \$1,000,000	110	.7	100.0	354,316,821	46.6
<b>Total</b>	<b>16,544</b>	<b>100.0</b>		<b>760,424,921</b>	<b>100.0</b>

Source: LSA analysis of Indiana DOR data. Note: Percentages may not sum to 100 due to rounding.

**Table 9: 1999 Distribution of Corporate Tax Liability: Corporations with Indiana Location(s) only**

Corporate Income Tax Liability	Number of Returns	Percent of Returns	Cumulative Percent of Returns	Income Tax Liability (\$)	Percent of Total Tax Liability
NONE (No Tax Liability)	13,199	49.4	49.4	0	0.0
\$1 - \$5,000	10,685	40.0	89.4	12,282,736	6.1
\$5,000 - \$10,000	1,183	4.4	93.9	8,304,768	4.1
\$10,000 - \$25,000	838	3.1	97.0	12,975,046	6.5
\$25,000 - \$50,000	328	1.2	98.2	11,498,602	5.7
\$50,000 - \$100,000	217	.8	99.1	15,437,088	7.7
\$100,000 - \$250,000	153	.6	99.6	23,407,425	11.7
\$250,000 - \$500,000	57	.2	99.8	19,385,115	9.7
\$500,000 - \$1,000,000	19	.1	99.9	13,527,359	6.7
Over \$1,000,000	22	.1	100.0	83,737,303	41.8
<b>Total</b>	<b>26,701</b>	<b>100.0</b>		<b>200,555,442</b>	<b>100.0</b>

Source: LSA analysis of Indiana DOR data. Note: Percentages may not sum to 100 due to rounding.

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